

***National Federation of Municipal Analysts***  
***White Paper on Disclosure for GASB 45***  
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The National Federation of Municipal Analysts (NFMA) is an organization of over 1,000 members, primarily research analysts, who evaluate credit and other risks of municipal securities. These individuals represent, among others, mutual funds, insurance companies, broker/dealers, bond insurers, and rating agencies.

One of NFMA's main initiatives is to promote timely and complete disclosure of financial and operating information needed to assess the credit quality and risk of a municipal debt issue. NFMA's efforts in this regard have ranged from global disclosure-related issues to more detailed, sector-specific work. For further information on our continuing work in the area of disclosure, please see "Disclosure Guidelines" and "Position Statements" on NFMA's web site at [www.nfma.org](http://www.nfma.org).

The following discussion takes the form of a "White Paper" rather than a "Recommended Best Practices in Disclosure". White Papers are NFMA's preferred method of comment when disclosure practices are in a formative stage. As current GASB 45 disclosure develops, we anticipate that this White Paper will help catalyze industry discussion as to what improved disclosure practices should entail. Recommended Best Practices in Disclosure (RBPs), on the other hand, are utilized when a given analytical topic or credit sector has existed for a prolonged period of time. When RBPs are developed, diverse groups of NFMA analysts work with other market professionals who are knowledgeable about a topic to develop "best practices" guidelines for certain market sectors or topics. The intent of this White Paper is to provide analysts a framework for analyzing GASB 45-related material.

This document is not intended to supplant the amendments to Rule 15c2-12, but to be used in conjunction with the guidance provided in the Rule and its amendments. Please note that NFMA's disclosure efforts are a continuing process. This White Paper, and Recommended Best Practices papers, are not static documents but will be revised as market conditions warrant. We encourage interested parties to submit comments to [lgood@nfma.org](mailto:lgood@nfma.org) for consideration in future versions of this White Paper.

Neither the recommendations included in this White Paper nor the information within it are intended to apply equally to all situations and issuers. We encourage providers of information to indicate when a specific item requested in the White Paper is not applicable to a specific issuer's situation.

## **I. INTRODUCTION:**

The NFMA’s GASB 45 Disclosure Task Force was formed to produce a White Paper to comment on disclosure requirements created by GASB Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (“OPEB”). The NFMA concurs with the Governmental Accounting Standards Board (“GASB”) that Statement No. 45 addresses the need for governments to provide more complete information about the size of long-term financial obligations and commitments related to OPEB. The NFMA believes that OPEB obligations should be disclosed and that GASB standards are the best way to do so.

The NFMA recommends issuers comply with disclosure standards of GASB 45<sup>1</sup> and to supply the following information to municipal market participants:

- General GASB 45 requirements, including:
  - Definition of plan type;
  - Estimate of OPEB liability and explanation of key assumptions used to arrive at that liability, such as the discount rate, medical inflation rate, employee turnover, and retirement and mortality assumptions;
  - Ability of an issuer to eliminate or reduce benefits; and
  - Discussion of funding method selected.
- As much supplemental disclosure as necessary to effectively explain and communicate to the market a specific OPEB situation and funding approach.
- The most recent actuarial report for the system an issuer belongs to or participates in. The actuarial report should be available either online or by mail. Online access is preferable, with clear indication of the URL at which the report can be accessed.
- Any other OPEB actuarial study.

Disclosure of information in addition to that required by GASB can help analysts to better understand an issuer’s current and future financial prospects. NFMA realizes that GASB 45 does not require funding of OPEB plans but expects that GASB 45 will lead state and local governments to more actively consider funding options.

## **II. BACKGROUND:**

The GASB issued Statement No. 45 in June 2004 to “improve the faithfulness of representations and usefulness of information included in the financial reports of state and local government employers regarding other postemployment benefits”<sup>2</sup>. OPEB refers to postemployment benefits other than pension benefits. These generally take the form of health and dental insurance and related benefits provided to retirees and/or their beneficiaries. OPEB may also include some types of life insurance, legal services, and other benefits. State and local government employers subject to GASB 45 include public colleges and universities, school districts, public power providers, correctional facilities, and others.

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<sup>1</sup> Note: Failure to provide adequate OPEB disclosure will constitute non-conformance with GAAP.

<sup>2</sup> GASB Statement No. 45, June 2004.

Most issuers have historically recognized the annual outlays required to pay OPEB but have not accrued a liability for future OPEB obligations. Under GASB's new standards, OPEB costs are accrued, i.e. future benefits are measured and reported as they are earned by an employee during his or her period of employment. Actuarial methods used to estimate OPEB liabilities are similar to those for pension plans; however, OPEB is often considered to be an even more volatile liability than pensions because it varies not only with trends in medical costs but with retirement rates, salary patterns, employer versus employee contributions, and other factors that are incorporated as well into pension calculations.<sup>3</sup> In addition to this inherently greater volatility, NFMA notes that employers may have considerable legal and political latitude to redefine OPEB benefits.

Unlike pensions, which tend to be legally vested rights, OPEB may be subject to significant adjustment. In effect, GASB 45 requires disclosure of an issuer's "substantive plan", regardless of whether it is a vested benefit. Many governments are likely to weigh their options carefully before committing to full or partial funding of their OPEB liabilities.

The new GASB accounting standards for OPEB have begun to be implemented for most state and local governments, with the smallest such governments adopting the standards in their current fiscal years.

#### GASB 45 Compliance Dates

- Governments with total revenue of \$100 million or more must have complied in their fiscal year that began after 12/15/06.
- Governments with total annual revenue between \$10 million and \$100 million must have complied in their fiscal year that began after 12/15/07.
- Governments with annual revenue less than \$10 million must comply in their fiscal year that has begun after 12/15/08.

### **III. NFMA VIEWS ON DISCLOSURE AND MINIMUM REQUIREMENTS:**

Governments' approaches to financing OPEB are evolving. Until the release of GASB 45, many governments had never considered the long-term cost of their OPEB plan and thus had not contracted for actuarial valuations of those costs. The NFMA believes that GASB 45 will result in OPEB information that is more useful and readily understandable to the capital markets.

Actuarial valuations are based on numerous assumptions that can vary significantly. These factors include the number of employees expected to receive benefits, how many years employees will work, employee mortality rates, inflation of healthcare costs, and rate of return on any investments that are held for OPEB funding. Although some issuers' prospective OPEB liabilities have been large, we realize that an issuer's plan to address the liability can be as important as the liability itself.

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<sup>3</sup> Fitch Ratings, "Old Promises, Emerging Bills: Considering OPEB in Public Finance Ratings", March 22, 2007.

Under GASB 45, the discount rate is a major determinant of the liability. The discount rate, also known as the investment return assumption, is the estimated long-term yield on the investments that are expected to finance the payment of OPEB benefits.

Issuers that will pay their OPEB expenses as they come due and will not actuarially fund their OPEB expenses will have a low discount rate, e.g. the interest rate earned on its short-term funds. By contrast, issuers that employ actuarial funding will be able to invest funds at higher, long-term rates and will thus enjoy the benefits of a higher discount rate. This in turn lowers the long-term amount of OPEB contributions needed. The discount rate assumption can therefore have a significant impact on the size of an issuer's OPEB liability. For an example, please refer to the California example in Appendix II, "Effect of GASB 45 on Governmental Financial Statements".

Intuitively, it seems advantageous for a government to create an irrevocable trust to fund OPEB liabilities in order to take advantage of higher discount rates. However, competing budgetary requirements may prevent some issuers from setting aside funds to meet future liabilities, and in addition some governments are constrained by the issue of whether creation of a trust is permitted under state or local law. To address the latter problem, some governments might entertain specific legislative action to establish a trust. Others might consider legislative action to endow a trust with bonding authority, so that OPEB bonds (similar to pension obligation bonds) can be used as part of the solution to address OPEB liabilities<sup>4</sup>.

Another key assumption used in OPEB actuarial studies is the medical inflation rate. As is the case with the discount rate, small changes in the rate of assumed medical inflation can have a major impact on the size of an OPEB liability and the resulting Annual Required Contribution (ARC). Employee turnover, retirement and mortality assumptions are also significant. In some cases, governments also have the ability to eliminate or reduce benefits in order to manage the size of their OPEB liability going forward. Disclosure of considerations such as these is helpful in providing some context to market participants of an issuer's OPEB valuation.

With so much potential for variation, analysts must rely on the OPEB estimate as just that. Nonetheless, it is an important tool for many reasons. From the standpoint of market participants, simply quantifying the OPEB liability as a financial obligation forces government officials to consider this amount when contemplating decisions that affect the future financial health of their jurisdiction. The requirements created by GASB 45 also provide credit analysts with at least an indication of the direction of the OPEB liability and contribution efforts over time.

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<sup>4</sup> Note: An OPEB trust does not necessarily need bonding authority in order to use debt to fund the liability. In most but not all cases, the sponsor issues the bonds and gives the proceeds to the trust. Only when there are unique legal constraints on the ability of the sponsor to issue bonds does the bonding authority of the trust need to be considered.

The NFMA expects issuers to comply with the standards required by GASB 45. Additionally, the NFMA encourages issuers to provide as much supplemental disclosure as necessary to effectively explain and communicate their specific OPEB situation and funding approach to the market. We expect that a great deal of variation on this point will develop on an issuer-by-issuer basis, at least until GASB 45 requirements have had a chance to take hold. For example, any steps an issuer takes to address an OPEB liability, such as setting up a qualifying OPEB trust or creating OPEB reserves, have wide-ranging implications that are extremely important to the credit analysis of local governments and their OPEB obligations.

Depending on the accounting method chosen, resulting OPEB liabilities could make an issuer's situation look either better or worse than it really is. Also, whether an employer is in a single employer or agent multiple employer plan versus a cost-sharing multiple employer plan can affect the amount paid for annual OPEB expense. For single employer or agent multi employer plans, the annual OPEB cost equals the ARC plus or minus certain adjustments if the employer's actual contributions in prior years differed from the ARC. The annual OPEB cost is the OPEB expense that a government would report in its accrual-based financial statements. For cost-sharing multiple employer plans, the annual OPEB expense is equal to the employer's contractually required contribution to the plan (i.e., the amount assessed by the plan for the period) which may or may not equal the ARC. Market participants will look to evaluate differences between funding methods and plan types as well as make analytic comparisons between issuers. More expansive disclosure will facilitate these activities.

At a minimum, the NFMA expects all issuers to include in their overall OPEB disclosure statements an estimate of the OPEB liability and the list of assumptions used to arrive at that liability. These assumptions are key to the analysis of an issuer's OPEB liability and should be clearly presented in offering documents and annual financial reports.

One of the inherent challenges of precisely identifying an issuer's OPEB liability is created by the time lag that naturally occurs in producing actuarial reports. By including an executive summary of the most recent actuarial report (including assumptions, results, plan description, funded status, legal basis for providing benefits and other key takeaways) in offering documents and annual financial statements, issuers can assist market participants in assessing OPEB liability exposure.

#### **IV. CONCLUSION**

The NFMA agrees with the GASB that Statement 45 fosters “improved accountability and a better foundation for informed policy decisions about the level and types of benefits provided and potential methods of financing those benefits”<sup>5</sup>.

At this stage in the GASB 45 implementation process, governmental disclosure efforts vary widely in terms of the level of detail and in the type of information incorporated. In the absence of any standard disclosure format, the NFMA encourages issuers to

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<sup>5</sup> Source: *GASB Statement 45 on OPEB Accounting by Governments: A Few Basic Questions and Answers*.

recognize the findings of any OPEB actuarial study as material. We believe it would be helpful for actuarial reports to be accurately summarized and feel that it would be beneficial if results and necessary funding are regularly considered as part of an issuer's annual budget process, and that an action plan to address OPEB liabilities is developed. The NFMA also urges issuers to provide as much context as necessary when explaining OPEB liabilities. Without sufficiently explaining the data presented, the disclosure of an OPEB liability can be misleading to credit analysts in their assessment of an issuer's overall financial position.

To reiterate, the NFMA seeks the following GASB 45-related disclosure of participating issuers:

- Compliance with the standards required by GASB 45, including:
  - Definition of the plan type,
  - Estimate of the OPEB liability and an explanation of key assumptions (e.g. discount rate, medical inflation rate, employee turnover, and retirement and mortality assumptions),
  - Discussion of the flexibility to eliminate or reduce benefits, and
  - Description of funding method selected.
- Provision of as much supplemental disclosure as necessary to effectively explain and communicate a specific OPEB situation and funding approach.
- Instructions regarding how to obtain the most recent actuarial report for the system an issuer belongs to or participates in. The actuarial report should be available either online or by mail. Online access is preferable, with clear notation as to the specific online address.

The NFMA and our members look forward to monitoring and reviewing GASB 45 disclosure efforts over the next few years as the availability of information accelerates. Among the areas we hope to evaluate are methods that improve the comparability of OPEB liabilities among issuers. To date, various approaches have been employed towards this effort, including determining OPEB per capita estimates and comparing annual required contributions to overall general fund spending. Over time, other applications may become apparent.

The NFMA will collect and consider GASB 45 disclosure samples and provide a future update to this report with the objective of highlighting recommended best practices in the next few years.

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**APPENDICES**

- I. SUMMARY OF GASB 45 REQUIREMENTS**
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## APPENDIX I - SUMMARY OF GASB 45 REQUIREMENTS

Primary disclosure requirements of GASB 45 are summarized below<sup>6</sup>.

### A. Accounting for OPEB

Governments must now report OPEB and related obligations and commitments on an actuarial basis. This is similar to reporting requirements for pension systems. Advance funding of OPEB obligations is not required.

### B. Actuarial parameters established by GASB

- a. Valuations should be conducted at least every 2 years for plans that administer OPEB for 200 or more plan members (both active employees and retirees) or at least every 3 years for plans with fewer than 200 members.
- b. Valuations generally should follow accepted actuarial practices as set forth by the Actuarial Standards Board.
- c. Six actuarial cost methods are allowable.
- d. Implicit rate subsidies, which result when premiums paid by a group cost less than they would had the retirees been insured separately, should be included by governments as OPEB.

### C. Note disclosures required by GASB

- a. Plan description
  - i. Name of the plan and the plan administrator.
  - ii. Whether the plan issues a stand-alone financial report or is included in the report of another entity, along with where to obtain a copy of the report.
  - iii. Identification of the plan as a single employer, agent multiple employer, or cost sharing multiple employer defined benefit OPEB plan; disclosure of the number of participating employers and other contributing entities.
  - iv. Types of employees covered (e.g. general employees and public safety employees) and information on current members, including the number of retirees and beneficiaries currently receiving benefits, terminated members entitled to but not yet receiving benefits, and active members.
  - v. Brief description of benefit provisions, including the types of benefits and provisions for future benefit increases, along with the authority under which benefit provisions are established or may be amended.
  - vi. Authority (e.g. state law) under which obligations of the plan members, employer(s) and other entities that contribute to the plan are established or may be amended.
- b. Accounting policies
  - i. Basis of accounting, including the policy with respect to recognition in the financial statements of contributions; benefits paid, and refunds paid.
  - ii. Brief description of how the fair value of investments is determined.
- c. Contributions and Reserves
  - i. Authority under which obligations of the plan members, employer(s) and other contributing entities to the plan are established or may be amended.
  - ii. Funding policy, including a brief description of how plan contributions are determined, how the costs of administering the plan are financed, and any legal or contractual maximum contribution rates.

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<sup>6</sup> Source: GASB, Statement No. 45, June 2004 and “Other Postemployment Benefits: A Plain-Language Summary of GASB Statements No. 43 and No. 45”.



- iii. Any required contribution rates of active plan members.
- iv. Brief description of the terms of any long-term contracts for contributions to the plan and disclosure of the amounts outstanding at the reporting date.
- v. The balance in the plan's legally required reserves at the reporting date, as well as a brief description of the purpose of each reserve and disclosure whether the reserve is fully funded.
- d. Funded Status and Funding Progress
  - i. Funded status of the plan as of the most recent actuarial valuation date.
  - ii. Disclosure of actuarial methods and assumptions used in the valuations on which ARC information is based, annual OPEB cost, and funded status and funding progress of OPEB plans.

**D. Required supplementary information (RSI) required by GASB**

Governments generally should present RSI related to defined benefit OPEB plans covering the last three actuarial valuations. A government participating in a cost-sharing multiple-employer plan does not have to present RSI for OPEB as long as the plan issues its own separate financial report or is included in the financial report of another governmental entity.

Three types of RSI about defined benefit OPEB plans might be presented in a government's financial report:

- a. Schedule of funding progress: Provides information that helps the user judge how well funded the plan is by comparing funded ratio to number of employees covered.
- b. Schedule of employer contributions: Compares a government's contributions to its OPEB plan with its ARC to give the user an idea of how successful the government has been in funding contribution requirements.
- c. Notes to the RSI schedules: If a government is aware of any factors that have a significant effect on the information in the schedules of funding progress and employer contributions, it may add an explanatory note.

## **APPENDIX II - EFFECT OF GASB 45 ON GOVERNMENTAL FINANCIAL STATEMENTS**

One of the best ways to understand the effect of GASB 45 on governmental financial statements is to consider a few real-life examples.

In a June 2007 report, S&P considered the impact of GASB 45 on the State of California<sup>7</sup>. California has historically paid eligible retiree medical benefits on a pay-as-you-go basis. As part of its GASB 45 disclosure requirements, California announced that it has an estimated unfunded actuarial accrued liability of \$47.88 billion for retiree healthcare benefit programs. The actuarially recommended annual required contribution in FY 08 to amortize the unfunded liability over 30 years was \$3.59 billion. Among the various actuarial assumptions used in the State's calculation of its OPEB liability was a 4.5% discount rate. This discount rate is reflective of the State's interest earnings on its short-term pooled money funds.

In its FY08 budget, California set aside \$1.38 billion for pay-as-you-go OPEB spending. This amount was \$2.21 billion less than the actuarially recommended ARC. This shortfall will appear on California's FY08 balance sheet as a liability on the statement of net assets and will increase in future years to the extent that the ARC is not fully funded. The overall \$47.88 billion OPEB liability will be disclosed separately in the notes to the financial statements.

Conversely, if California set aside funds for OPEB incurred in a current year but paid out in a future year, it could invest those funds for a longer term than the state's short-term money market pool. This would allow the actuarially assumed rate of return to be higher, increasing the discount rate and lowering the long-term amount of State contributions needed. If California fully funded its ARC, an actuarially assumed discount rate of 7.75% could be used. This would have reduced FY08 OPEB from \$47.88 billion on a pay-as-you-go basis to \$31.28 billion.

One of the more substantial dedications of resources among governments to address its future OPEB liability occurred in New York City. The city implemented GASB 45 two years before the GASB reporting requirements required it to do so and identified an unfunded liability of \$53.5 billion. This amount was counted as a one-time charge in its fiscal 2006 financial statements. The city deposited \$2 billion in a retiree health benefits trust fund (RHBTF) to offset future OPEB liabilities in FY07, with another \$500 million budgeted for FY08. The RHBTF is an irrevocable trust enacted by local law. The funds set aside in the RHBTF represent a down payment for benefits currently funded on a pay-as-you-go basis.

A common misconception is that GASB 45 requires immediate reporting of a financial statement liability for the entire unfunded actuarial accrued liability. In reality, governments apply Statement 45 prospectively, such that at the beginning of the year of implementation, nearly all governments will start with zero financial statement liability<sup>8</sup>. Thereafter, a net OPEB obligation is accumulated if a government's actual OPEB contributions are less than its annual OPEB cost. The net OPEB obligation will increase over time at varying rates depending on the policy a government selects to fund OPEB (for example, a pay-as-you-go policy will increase more rapidly than a pre-funded approach). Generally, the more a government defers its annual OPEB

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<sup>7</sup> Standard & Poor's, "California's OPEB Liabilities are Prompting a Review of Future Funding Decisions", June 26, 2007.

<sup>8</sup> GASB, "GASB Statement 45 on OPEB Accounting by Governments: A Few Basic Questions and Answers".

cost, the higher its unfunded actuarial accrued liability will be and the greater cash flow demands will be in future years.

In financial statements that use accrual accounting, including the government-wide financial statements and proprietary and fiduciary fund financial statements, a government is not required to place an initial OPEB liability on the statement of net assets when GASB 45 is first implemented. According to the GASB, “OPEB expense in relation to the ARC should be recognized in an amount equal to annual OPEB cost, regardless of the amount actually contributed to the plan in relation to the ARC. The cumulative difference between the amount expensed (annual OPEB cost) and the amounts contributed in relation to the ARC creates a net OPEB obligation (liability or asset)”<sup>9</sup>.

Under modified accrual accounting in the governmental fund financial statements, a government would report OPEB expenditures equal to the amount contributed to the plan or expected to be liquidated with expendable available financial resources. Because governmental fund financial statements focus on current financial resources, they would not include the net OPEB obligation or any other long-term liability.

As a result of GASB 45, governments will report the estimated cost of OPEB benefits as an expense in each year. Additionally, the users of financial statements will have more information about a government’s unfunded actuarial accrued liabilities and the changes in funded status over time.

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<sup>9</sup> GASB Statement No. 45, page 103, June 2004.

### APPENDIX III - GLOSSARY<sup>10</sup>

- *Accrual Accounting*: An accounting system that recognizes income when it is earned and expenses when they are incurred, rather than when they are received or paid.
- *Actuarial Approach*: The amount, if invested now, sufficient to finance a pension or OPEB plan's benefits after they are no longer working for the government.
- *Actuarial Accrued Liability (AAL)*: Portion of the actuarial present value allocated to prior years of employment and thus not provided for by future normal costs.
- *Actuarial Present Value*: The estimated present value of future cash outlays for OPEB at a discount rate equal to an assumed long-term rate of return on investments.
- *Agent Multiple-Employer Benefit Plan*: A type of OPEB plan where there is no pooling of benefit costs. Separate actuarial calculations are made for each participating government in the plan and separate accounts are maintained to ensure that each employer's contributions are being used to provide benefits only for the employees of that government. The plan allocates the liability to each participating entity so that proportionate liabilities appear on each participant's financial statements. The cost of administering the plan is shared by the participating governments.
- *Annual Required Contribution (ARC)*: The amount, if paid on an ongoing basis, that would provide sufficient resources to fund both the normal cost for each year and the amortized unfunded liability.
- *Cost Sharing Multiple Employer Benefit Plan*: A type of OPEB plan in which governments share assets accumulated to pay benefits, the costs of financing those benefits, and plan administrative costs. The liability is typically reported in a separate audit with no formal allocation to an individual issuer.
- *Defined Benefit OPEB plans*: A type of OPEB plan that specifies the amount of benefits to be provided to the employees at the end of their employment.
- *Defined Contribution OPEB plans*: A type of OPEB plan that stipulates only the amounts to be contributed by an employer to a member's account each year of active employment. Does not specify the amount of benefits employees will receive at the end of their employment.
- *Discount Rate (or Investment Return Assumption)*: The estimated investment yield on funds that are expected to be used to finance the payment of benefits, with consideration given to the nature and mix of current and expected investments and the basis used to determine the actuarial value of assets.
- *Funded Ratio*: The actuarially-determined present value of assets, expressed as a percentage of the actuarial accrued liability.

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<sup>10</sup> All glossary definitions are excerpted from GASB Statement No. 45.

- *Implicit Rate Subsidy*: In health insurance plans where a government’s retirees and current employees are insured together as a group, the premiums paid by the retirees may be lower than they would have been if they were insured separately.
- *Modified Accrual Accounting*: A basis of accounting in which expenditures are accrued but revenues are accounted for on a cash basis. This accounting technique is a combination of cash and accrual accounting since expenditures are immediately incurred as a liability while revenues are not recorded until they are actually received or are “measurable” and “available for expenditure”.
- *Multi-Employer Plans*: A type of OPEB plan that includes more than one government.
- *Normal Cost*: The portion of actuarial present value allocated to a particular year.
- *Other Post-Employment Benefits (OPEB)*: Postemployment benefits other than pensions, which may include health, dental, vision, prescription, and life insurance.
- *Pay-as-you-go Approach*: Payment by a government of only those OPEB benefits that are distributed or claimed in a given year.
- *Single Employer Plan*: A type of OPEB plan that involves only one government and serves as a direct vehicle for that government to provide post-employment benefits for its employees. Recognized on the issuer’s financial statements.
- *Unfunded Actuarial Accrued Liability (UAAL or unfunded liability)*: Excess of the AAL over the actuarial value of assets. Under actuarial guidelines, the AAL can be amortized over a period of up to 30 years (approximately equal to a typical public employee’s term of employment).

APPENDIX IV -  
**“OTHER POSTEMPLOYMENT BENEFITS: A PLAIN-LANGUAGE SUMMARY OF  
GASB STATEMENTS 43 AND NO. 45”**

# **Governmental Accounting Standards Board**

## **Other Postemployment Benefits: A Plain-Language Summary of GASB Statements No. 43 and No. 45**

*Please note: This document, prepared by the GASB staff, has not been reviewed or approved by the GASB Board and is not an authoritative document in the hierarchy of generally accepted accounting principles.*





# Governmental Accounting Standards Board

## Other Postemployment Benefits: A Plain-Language Summary of GASB Statements No. 43 and No. 45

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## **WHAT ARE OTHER POSTEMPLOYMENT BENEFITS, AND WHY ARE THEY IMPORTANT?**

Employees of state and local governments may be compensated in a variety of forms in exchange for their services. In addition to a salary, many employees earn benefits over their years of service that will not be received until after their employment with the government ends through retirement or other reason for separation. The most common type of these postemployment benefits is a pension. As the name suggests, *other postemployment benefits* (OPEB) are postemployment benefits *other than pensions*. OPEB generally takes the form of health insurance and dental, vision, prescription, or other healthcare benefits provided to eligible retirees, including in some cases their beneficiaries. It may also include some types of life insurance, legal services, and other benefits.

### **Why Has the GASB Issued New Standards for OPEB?**

The GASB established standards in 1994 for how public employee pension plans and governmental employers participating in pension plans should account for and report on pension benefits, but similar provisions did not exist for OPEB. Although the OPEB may not have the same legal standing as pensions in some jurisdictions, the GASB believes that pension benefits (as a legal obligation) and OPEB (as a constructive obligation in some cases) are a part of the compensation that employees earn each year, even though these benefits are not received until after employment has ended. Therefore, the cost of these future benefits is a part of the cost of providing public services *today*. However, most governments report their *cash outlays* for OPEB in a given year, rather than the *cost to the employer of OPEB earned by employees* in that year; these two amounts may be vastly different. In the absence of standards similar to those the GASB enacted for pensions, *most governments do not report the full cost of the OPEB earned by their employees each year*.

Furthermore, most governments do not report information about the nature and size of their long-term financial obligations and commitments related to OPEB. Consequently, the readers of financial statements, including the public, have incomplete information with which to assess the cost of public services and to analyze the financial position and long-run financial health of a government. The purpose of the new standards—GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*—is to address these shortcomings.

### **What Types of OPEB Plans Do Governments Use?**

There are two basic forms of postemployment benefit plans. *Defined benefit* plans are those that specify the *amount of benefits to be provided* to the

employees after the end of their employment. *Defined contribution* plans stipulate only the *amounts to be contributed by a government employer* to a plan member's account each year of active employment, and do not specify the amount of benefits employees will receive after the end of their employment.

Plans may also be distinguished by how many employers participate in them. As their name indicates, *single-employer* plans involve only one government, whereas *multiple-employer* plans include more than one government. In a *cost-sharing multiple-employer* plan, governments *pool or share* the costs of financing benefits and administering the plan and the assets, if any, accumulated to pay benefits. Generally, a single actuarial valuation is conducted for all of the employees of the participating governments *combined*.

In *agent multiple-employer* plans, there is no pooling of benefit costs. Separate actuarial calculations are made for each participating government in the plan, and separate accounts are maintained to ensure that each employer's contributions are used to provide benefits only for the employees of that government. The cost of administering the plan, however, is shared by the participating governments.

### **How Do Governments Currently Finance Postemployment Benefits?**

In general, postemployment benefits are financed in one of two ways. Some governments follow an *actuarial* approach, which entails paying to a pension or OPEB plan an amount that is expected to be sufficient, if invested now, to finance the benefits of employees after they are no longer working for the government. This approach is commonly followed for determining pension contributions.

For OPEB, however, most governments currently follow a *pay-as-you-go* approach, paying an amount each year equal to the benefits distributed or claimed in that year. The new OPEB standards do not mandate the funding of OPEB benefits (in other words, to set aside assets in advance to pay benefits in the future). As noted above, they address accounting and financial reporting issues only.

### **HOW SHOULD GOVERNMENTS PARTICIPATING IN DEFINED BENEFIT PLANS ACCOUNT FOR OPEB?**

*In general, governments should account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in the same manner as they currently do for pensions.* These amounts should be produced by actuarial valuations performed in accordance with parameters established by the GASB. The valuations should be conducted at least every two years for plans that administer OPEB for 200 or more plan members (both active

employees and retirees) or at least every three years for plans with fewer than 200. Actuarial valuations generally should follow accepted actuarial practices as set forth by the Actuarial Standards Board.

### **How Should Governments Determine the Cost of OPEB?**

The process of determining how much should be set aside now in order to provide for future benefits in a defined benefit plan utilizes actuarial methods and assumptions. An actuary's estimate or "valuation" is the product of many assumptions, based on historical experience, regarding the factors that determine the level of resources that will be needed in the future to finance benefits. These factors may include, but are not limited to:

- How many employees a government is expected to have that will receive benefits
- How long employees are expected to work for the government
- How long employees are expected to live after retiring (and, hence, how many years they will receive benefits)
- How much healthcare costs are expected to increase
- How large a return a government is expected to receive on its investments.

The actuary calculates *how much should be contributed now* to ensure that an adequate level of resources is available in the future. The future cash outlays for OPEB should be projected based on economic and demographic assumptions such as those mentioned above. These cash outflows would then be discounted to their *actuarial present value*—their estimated value if paid today—using a discount rate equal to an assumed long-term rate of return on investments. The actuarial present value generally would be spread over a period that approximates the anticipated years of an average worker's employment with the government, utilizing any one of six acceptable actuarial cost methods. The portion of the actuarial present value allocated to a particular year is called the *normal cost*. The portions allocated to the remaining years of employment are future normal costs.

The Board's decision to allow a choice among six methods reflects the fact that actuaries have developed a variety of methods to help determine how to fund pension and OPEB plans. The selection of a particular method generally is based on a recommendation from the actuary based on demographics, benefits offered, and the funding status of the plan. The Board believes it is most appropriate and useful to the users of financial statements if a government uses the same actuarial cost method for both funding and financial reporting, as long as the government's funding method is consistent with the principles of accrual-based accounting. If its funding method is not consistent, then a government should select from the six allowable actuarial cost methods for the purposes of financial reporting.

**The OPEB Liability.** The actuarial calculations are required to take into account not only benefits *expected to be earned* by employees in the future (future normal costs), but also those benefits the employees *have already earned*. One reason for this is that governments had been granting pension and OPEB benefits for many years before the accounting standards required their costs and obligations to be actuarially determined. Second, governments sometimes *retroactively* improve the benefits they provide to their employees. The portion of the actuarial present value allocated to prior years of employment—and thus not provided for by future normal costs—is called the *actuarial accrued liability* (AAL).

**OPEB Assets.** If an OPEB plan has cash, investments, and other resources, these may be applied to fund the actuarial accrued liability. The value of these resources is referred to as the *actuarial value of assets*. The actuarial value of assets is not the same as fair value, which is used to report a government's investments in its statements of net assets and balance sheet. Fair values can be volatile in the short term, with gains one year and losses the next. Postemployment benefits, however, are long-term transactions—assets are being set aside today to pay for benefits well into the future. Although there may be sharp changes in asset value in the short run, over the long run the change in asset value tends to be steadier. For financial reporting purposes, gains or losses in plan assets are averaged over several years (usually three to five), producing an actuarial value of assets that is more stable over time than fair value.

**The Unfunded Liability.** The excess of the AAL over the actuarial value of assets is the *unfunded actuarial accrued liability* (UAAL or unfunded liability). The unfunded liability would be amortized (spread) over a period of up to thirty years (approximately equal to a typical public employee's term of employment), either in *level dollar* amounts or as a *level percentage of projected payroll*. Like a home mortgage, the level dollar method divides the liability into equal dollar amounts over the selected number of years; each payment is part interest, part principal. The level percentage method calculates payments so that they equal a constant percentage of payroll over time as payroll increases; most governments currently use this method when reporting their pension benefits.

**OPEB Contributions.** The normal cost and the portion of the UAAL to be amortized in the current period together make up the *annual required contribution* (ARC) of the employer for the period. The ARC is an amount that is actuarially determined in accordance with the requirements of Statements 43 and 45 so that, if paid on an ongoing basis, it would be expected to provide sufficient resources to fund both the normal cost for each year and the amortized unfunded liability. Employer contributions consist of payments directly to or on behalf of a retiree or beneficiary, premium payments to insurers, or irrevocably transferred assets to a trust (or equivalent arrangement) in which plan assets are dedicated to providing benefits to retirees and beneficiaries in accordance with the terms of

the plan and are legally protected from creditors of the employer and plan administrator.

**OPEB Expenses, Expenditures, and the Net Obligations.** For a government in a single-employer or agent multiple-employer plan, the *annual OPEB cost* equals the ARC plus or minus certain adjustments if the employer's actual contributions in prior years differed from the ARC. The annual OPEB cost is the OPEB *expense* that a government would report in its accrual-based financial statements—the government-wide statements and the proprietary fund statements. Generally, the cumulative sum of differences between an employer's annual OPEB cost and the amounts *actually contributed* to the plan since the effective date of the standards makes up a liability (or asset) called the *net OPEB obligation*.

By contrast, for an employer government participating in a cost-sharing multiple-employer plan, the annual OPEB expense is equal to the employer's *contractually required contribution* to the plan—the amount assessed by the plan for the period—which may or may not equal the ARC.

In the financial statements that use accrual accounting a government is not required to place an initial liability on the statement of net assets when this standard is first implemented. Governments *may* report as a liability the accumulated differences between their actual contributions and the ARC for prior years, to the extent they have the necessary information to do so.

Under modified accrual in the governmental fund financial statements, an employer would report OPEB *expenditures* equal to *the amount contributed to the plan or expected to be liquidated with expendable available financial resources*. Because the governmental fund financial statements focus on current financial resources, they would not include the net OPEB obligation or any other long-term liability.

### **Implicit Rate Subsidies for Retirees**

In health insurance plans where a government's retirees and current employees are insured together as a group, the premiums paid by the retirees may be lower than they would have been if the retirees were insured separately—this is called an *implicit rate subsidy*. Some believe that if the retirees pay 100 percent of their premiums without a specific contribution from the employer, then the employer should not be required to treat the implicit rate subsidy as an OPEB. The standards that were first proposed for public review were consistent with that point of view.

However, based on the comments received regarding those proposed standards, the GASB ultimately concluded in Statements 43 and 45 that exempting governments from including an implicit rate subsidy in their OPEB

calculations would result in the annual cost and long-term obligations of their OPEB being significantly understated. Implicit rate subsidies should therefore be included by governments as OPEB.

### **Provisions for Small Plans**

As mentioned above, actuarial valuations are required at least every two or three years, depending on the size of the OPEB plan. In recognition of the potential cost of hiring consultants to perform these valuations, the standards allow the smallest single-employer plans—those with fewer than one hundred members—and the employers that participate in them to estimate the AAL and the ARC using simplified methods and assumptions. (The method also is available to certain employers in agent multiple-employer plans.) The specifics of this *alternative measurement method* are described fully in Statements 43 and 45.

### **WHAT ADDITIONAL OPEB INFORMATION SHOULD A GOVERNMENT EMPLOYER PRESENT IN ITS FINANCIAL REPORT?**

#### **Notes to the Financial Statements**

To assist users in understanding the nature of a government's OPEB and its efforts to finance its OPEB, the GASB's standards require governments to prepare note disclosures to accompany the expense, expenditure, and liability information reported in the financial statements.

**Plan Description.** Disclosures describing the plan contain the following basic information about the types of OPEB offered and how they are administered. (See Illustrations 1–3 at the end of this document.)

- a. Name of the plan, identification of the public employee retirement system or other entity that administers the plan, and identification of the plan as a single-employer, agent multiple-employer, or cost-sharing multiple-employer defined benefit OPEB plan.
- b. Brief description of the types of benefits and the authority under which benefit provisions are established or may be amended. For example, the disclosure might reveal that a plan provides retirement, disability, and death benefits to plan members and their beneficiaries, and that a specific section of state law regulates the changing of benefit provisions.
- c. Whether the OPEB plan issues a *stand-alone financial report* or is included in the report of a public employee retirement system or another entity and, if so, how to obtain the report.

**Funding Policy.** Governments should disclose the following funding policy information about how contributions are made toward financing OPEB:



- a. Authority (for example, state statute) under which the obligations of the plan members, employer(s), and other contributing entities (for example, state contributions to local government plans) to contribute to the plan are established or may be amended.
- b. Required contribution rate(s) of active plan members.
- c. Required contribution rate(s) of the employer in accordance with the funding policy, in dollars or as a percentage of current-year covered payroll. If the plan is a single-employer or agent plan and the rate differs significantly from the ARC, a government should disclose how the rate is determined. If the plan is a cost-sharing plan, a government should disclose the required contributions in dollars, the percentage of that amount contributed for the current year and each of the two preceding years, and how the required contribution rate is determined. Governments should also disclose any legal or contractual limitations on the maximum amount of their contributions.
- d. A brief description of the terms of any long-term contracts for contributions to the plan and the amount still outstanding; for example, a government that is not able to make its full contribution in a given year might agree with the plan to make up the shortfall with interest in annual installments over a three-year period.

**Members and Types of Benefits.** If an employer government includes an OPEB plan in its financial statements as a trust or agency fund and the plan does not issue its own financial statements separate from those of the employer government, the employer also discloses the following information *about the plan as a whole*:

- a. The types of employees covered (such as general employees, police officers, legislators) and, for multiple-employer plans, the participating governments
- b. The number of members, sorted by (1) retirees and beneficiaries currently receiving benefits, (2) members no longer working for the government and entitled to benefits, but not yet receiving them, and (3) current employees
- c. A brief description of (1) the types of benefits provided and (2) provisions for cost-of-living adjustments or other future increases in benefits
- d. The balances remaining as of the date of the financial report in the plan's legally required reserves, a description of the purpose of the reserves, and whether the reserves are fully funded.

**Costs and Obligations, Methods and Assumptions.** Because governments participating in single-employer or agent multiple-employer plans are individually responsible for financing the OPEB cost of their own employees and retirees, these governments are required to provide additional information in their notes. The following additional disclosures are intended to help users assess whether the governments are keeping pace with actuarially required contribution amounts, the extent to which the resources set aside for paying

OPEB are sufficient or insufficient, and the methods and assumptions employed to conduct the actuarial calculations:

- a. For the current year, annual OPEB cost and the dollar amount of contributions actually made. If the employer has a net OPEB obligation, it should also disclose the components of annual OPEB cost, the increase or decrease in the net OPEB obligation, and the net OPEB obligation at the end of the year.
- b. For the current year and each of the two preceding years, annual OPEB cost, percentage of annual OPEB cost contributed that year, and net OPEB obligation at the end of each year.
- c. The funded status of the plan; this is the same information governments would be required to disclose in a schedule of funding progress (see below), but only for the most recent valuation date.
- d. Information about actuarial methods and assumptions used in the valuations that the information reported about the ARC, annual OPEB cost, and the funded status and funding progress of OPEB plans is based upon. (More details regarding this information can be found in Statement 45.)

### **Required Supplementary Information**

Governments generally should present RSI related to defined benefit OPEB plans covering *the last three actuarial valuations*. A government participating in a cost-sharing multiple-employer plan, however, does not have to present RSI for OPEB as long as the plan issues its own separate financial report or is included in the financial report of another governmental entity.

Three types of RSI about defined benefit OPEB plans might be presented in a government's financial report:

- a. Schedule of funding progress
- b. Schedule of employer contributions
- c. Notes to the RSI schedules.

The schedule of funding progress provides information that is useful for judging how well funded a pension plan is. (See page 18 for an illustrative example.) The first column shows the date as of which the information in the following columns was applicable. The next three columns show the actuarial value of assets, the AAL, and the UAAL. The fifth column divides asset value by the AAL—the *funded ratio*. A funded ratio can be as low as zero (for a pay-as-you-go system with no assets) and as high as 100 percent or even higher (for a fully funded system, or one that actually has assets that exceed the AAL, respectively). The second-to-last column in the schedule includes the covered payroll—the total payroll of the current employees covered by the plan. The last column then calculates a ratio of unfunded liability-to-payroll—dividing the UAAL by the covered payroll.

The schedule of employer contributions compares a government's actual contributions to its OPEB plan with its ARC. (See the illustration on page 26.) If a government is aware of any factors that have a significant effect on the trend information in the two RSI schedules, such as improvements or reductions in OPEB benefit provisions, expansion or reduction of the eligible population, or changes in the actuarial methods, it adds an explanatory note to the schedules.

Governments in single-employer and agent multiple-employer plans present funding progress information pertinent to the government's own members. If a government includes the OPEB plan in its financial statements as a trust fund and a separate report is not issued by the OPEB plan, then the government generally would present additional RSI:

- a. A government in a single-employer plan would add a schedule of employer contributions.
- b. A government in an agent plan would present a schedule of funding progress and a schedule of employer contributions *for the agent plan as a whole* (in addition to the schedule of funding progress the government is already presenting for just its own employees and retirees).
- c. A government in a cost-sharing plan would present a schedule of funding progress and a schedule of employer contributions *for the cost-sharing plan as a whole*.

## **WHAT INFORMATION SHOULD AN OPEB PLAN PRESENT IN ITS FINANCIAL REPORT?**

### **Financial Statements**

The financial report of a defined benefit OPEB plan includes two financial statements. The *statement of plan net assets* includes information about the plan's assets, liabilities, and net assets as of the end of the fiscal year. (See Illustration 4.) The *statement of changes in plan net assets* provides information about additions to, deductions from, and net increases or decreases in plan net assets during the fiscal year. Additions generally include employer and member contributions and investment income. Deductions typically are benefits and administrative expenses.

### **Notes to the Financial Statements**

Defined benefit OPEB plans should prepare note disclosures to give users information about plan description, accounting policies, contributions and reserves, and funded status and funding progress. (See Illustration 4.)

**Plan Description.** The following information is intended to inform the user about the nature of the plan, its members, and the OPEB it provides:

- a. Identification of the plan as a single-employer, agent multiple-employer, or cost-sharing multiple-employer defined benefit OPEB plan and disclosure of the number of participating employers and other contributing entities
- b. Classes of employees covered (for example, general employees and public safety employees) and information on the current members, including the number of retirees and beneficiaries currently receiving benefits, terminated members entitled to but not yet receiving benefits, and current active members
- c. Brief description of benefit provisions.

**Accounting Policies.** In its summary of significant accounting policies, a plan should disclose the accounting choices it has made relative to OPEB:

- a. Basis of accounting, including the policy with respect to recognition in the financial statements of contributions, benefits paid, and refunds paid
- b. Brief description of how the fair value of investments is determined.

**Contributions and Reserves.** The following information should be disclosed to help users understand how contributions are made to the plan and the amounts and purposes of the plan's reserves:

- a. Authority under which the obligations of the plan members, employer(s), and other contributing entities to contribute to the plan are established or may be amended
- b. Funding policy, including a brief description of how the contributions of the plan members, employer(s), and other contributing entities are determined, how the costs of administering the plan are financed, and any legal or contractual maximum contribution rates
- c. Required contribution rates of active plan members, in accordance with the funding policy
- d. Brief description of the terms of any long-term contracts for contributions to the plan and disclosure of the amounts outstanding at the reporting date
- e. The balances in the plan's legally required reserves at the reporting date, as well as a brief description of the purpose of each reserve and designation disclosed and whether the reserve is fully funded.

**Funded Status and Funding Progress.** Finally, plans should prepare a note disclosure containing the most recent information about their funded status and funding progress:

- a. The funded status of the plan as of the most recent valuation date
- b. Disclosure of information about actuarial methods and assumptions used in the valuations on which the information reported about the ARC, annual OPEB cost, and the funded status and funding progress of OPEB plans is based. (More details regarding this information can be found in Statement 43.)

## Required Supplementary Information

Following the notes, plans should present two schedules as required supplementary information. (See Illustration 4.) The *schedule of funding progress* shows historical trend information for the past three actuarial valuations about the funded status of the plan and efforts to accumulate sufficient resources to pay benefits when they come due. (This trend should cover a period as short as three fiscal years, if the valuation is conducted annually, or as long as nine years if the valuation is performed every three years.) The disclosure should include the actuarial valuation date, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded actuarial accrued liability, the actuarial value of assets as a percentage of the actuarial accrued liability (funded ratio), the annual covered payroll, and the ratio of the unfunded actuarial accrued liability to annual covered payroll.

To help users understand whether government contributions are keeping pace with amounts required by the actuarial calculations, the *schedule of employer contributions* should present historical trend information comparing the ARC with actual employer contributions for the fiscal years covered by the three most recent actuarial valuations. This should include the dollar amount of the ARC applicable to each year and the percentage of that ARC that was recognized in the plan's statement of changes in plan net assets for each year as contributions from the employer(s).

## WHEN SHOULD GOVERNMENTS IMPLEMENT THESE NEW STANDARDS?

The new standards should be implemented by *employers* in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Phase 1—governments with total annual revenues of \$100 million or more—periods beginning after December 15, 2006
- Phase 2—governments with total annual revenues of \$10 million or more, but less than \$100 million—periods beginning after December 15, 2007
- Phase 3—governments with total annual revenues of less than \$10 million—periods beginning after December 15, 2008.

The standards for OPEB plans are effective one year prior to the implementation date for the employer (in a single-employer plan) or for the largest participating employer in the plan (for multiple-employer plans).

## **WHAT IS THE GASB?**

The GASB is the private, nonpartisan, nonprofit organization that works to create and improve the rules U.S. state and local governments follow when accounting for their finances and reporting them to the public. The GASB was founded in 1984 under the auspices of the Financial Accounting Foundation (the Foundation), which appoints the GASB's board, raises its funds, and oversees its activities. The Foundation also oversees the GASB's counterpart for the private companies and not-for-profit organizations, the Financial Accounting Standards Board.

The mission of the GASB is to establish and improve standards of state and local governmental accounting and financial reporting that will:

- Result in useful information for users of financial reports, and
- Guide and educate the public, including issuers, auditors, and users of those financial reports.

Although the GASB does not have the power to enforce compliance with the standards it promulgates, the authority for its standards is recognized under the Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA). The Code requires auditors to note any departures from GASB standards when they express an opinion on financial reports that are presented in conformity with generally accepted accounting principles. Also, legislation in many states requires compliance with GASB standards, and governments usually are expected to prepare financial statements in accordance with those standards when they issue bonds or notes or otherwise borrow from public credit markets.

The GASB is composed of a full-time chair and six part-time members drawn from various parts of the GASB's constituency—state and local government finance officers, auditors, the accounting profession, academia, and persons who use financial statement information. The GASB has a professional staff drawn from similar constituencies as the Board. The staff works directly with the Board and its task forces, conducts research, analyzes oral and written comments received from the public, and drafts documents for consideration by the Board.

## **HOW DOES THE GASB SET STANDARDS?**

The GASB follows the set of “due process” activities enumerated in its published rules of procedure before issuing its standards. Due process is stringent and is designed to permit timely, thorough, and open study of financial accounting and reporting issues by the preparers, attestors, and users of

financial reports in order to encourage broad public participation in the standards-setting process.

For many issues it addresses, the GASB:

- Appoints an advisory task force of outside experts
- Studies existing literature on the subject and conducts or commissions additional research if necessary
- Publishes for public comment a discussion document setting forth the issues and possible solutions
- Conducts public hearings
- Broadly distributes an Exposure Draft of a proposed standard for public comment.

Significant steps in the process are announced publicly. The GASB's meetings are open to public observation and a public record is maintained. The GASB also is advised by the Governmental Accounting Standards Advisory Council, a 29-member group appointed by the Foundation and representing a wide range of the GASB's constituents.

Additional information about the GASB and its activities may be found at [www.gasb.org](http://www.gasb.org).

## **Illustration 1—Notes to the Financial Statements for an Employer Contributing to a Single-Employer Defined Benefit Healthcare Plan**

*[Note: This example assumes that the plan is included as an other employee benefit trust fund in the employer's financial reporting entity. Only those disclosures required by Statement 45 are illustrated. In accordance with footnote 21 of Statement 45, the requirement to present a schedule of funding progress covering at least three actuarial valuations would be met by complying with paragraphs 31 through 35 of Statement 43. That schedule is not illustrated here. Information required by Statement 43 because the plan is reported as an other employee benefit trust fund would be shown in addition to the information illustrated below. If the plan was not included in the employer's financial reporting entity, the employer would be required to present a schedule of funding progress similar to that included in Illustration 2.]*

### **State of Grande**

#### **Notes to the Financial Statements for the Year Ended June 30, 20X2**

##### **Note X. Postemployment Healthcare Plan**

*Plan Description.* State Retired Employees Healthcare Plan (SREHP) is a single-employer defined benefit healthcare plan administered by the Grande Retirement System. SREHP provides medical and dental insurance benefits to eligible retirees and their spouses. Article 37 of the Statutes of the State of Grande assigns the authority to establish and amend benefit provisions to the state legislature. The Grande Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for SREHP. That report may be obtained by writing to Grande Retirement System, State Government Lane, Latte, GR 01000, or by calling 1-800-555-PLAN.

*Funding Policy.* The contribution requirements of plan members and the state are established and may be amended by the state legislature. The required contribution is based on projected pay-as-you-go financing requirements, with an additional amount to prefund benefits as determined annually by the legislature. For fiscal year 20X2, the state contributed \$357.7 million to the plan, including \$190.7 million for current premiums (approximately 84 percent of total premiums) and an additional \$167.0 million to prefund benefits. Plan members receiving benefits contributed \$35.4 million, or approximately 16 percent of the total premiums, through their required contribution of \$50 per month for retiree-only coverage and \$105 for retiree and spouse coverage.

*Annual OPEB Cost and Net OPEB Obligation.* The state's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the *annual required contribution of the employer (ARC)*, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed



thirty years. The following table shows the components of the state’s annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the state’s net OPEB obligation to SREHP (dollar amounts in thousands):

Annual required contribution	\$577,180
Interest on net OPEB obligation	90,437
Adjustment to annual required contribution	<u>(95,258)</u>
Annual OPEB cost (expense)	572,359
Contributions made	<u>(357,682)</u>
Increase in net OPEB obligation	214,677
Net OPEB obligation—beginning of year	<u>1,349,811</u>
Net OPEB obligation—end of year	<u>\$1,564,488</u>

The state’s annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 20X2 and the two preceding years were as follows (dollar amounts in thousands):

<b><u>Fiscal Year Ended</u></b>	<b><u>Annual OPEB Cost</u></b>	<b><u>Percentage of Annual OPEB Cost Contributed</u></b>	<b><u>Net OPEB Obligation</u></b>
6/30/X0	\$497,538	67.4%	\$1,160,171
6/30/X1	538,668	64.8	1,349,811
6/30/X2	572,359	62.5	1,564,488

*Funded Status and Funding Progress.* As of December 31, 20X1, the most recent actuarial valuation date, the plan was 58.1 percent funded. The actuarial accrued liability for benefits was \$8.8 billion, and the actuarial value of assets was \$5.1 billion, resulting in an unfunded actuarial accrued liability (UAAL) of \$3.7 billion. The covered payroll (annual payroll of active employees covered by the plan) was \$2.2 billion, and the ratio of the UAAL to the covered payroll was 165 percent.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

*Actuarial Methods and Assumptions.* Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include

techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 20X1, actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 6.7 percent investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term investment returns on plan assets and on the employer's own investments calculated based on the funded level of the plan at the valuation date, and an annual healthcare cost trend rate of 12 percent initially, reduced by decrements to an ultimate rate of 5 percent after ten years. Both rates included a 4.5 percent inflation assumption. The actuarial value of assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a five-year period. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 20X1, was seventeen years.

## **Illustration 2—Notes to the Financial Statements and Schedule of Funding Progress for an Employer Contributing to an Agent Multiple-Employer Defined Benefit Healthcare Plan**

### **City of Mocha**

#### **Notes to the Financial Statements for the Year Ended June 30, 20X2**

##### **Note X. Postemployment Healthcare Plan**

*Plan Description.* The city's defined benefit postemployment healthcare plan, Mocha Postemployment Healthcare Plan (MPHP), provides medical benefits to eligible retired city employees and their beneficiaries. MPHP is affiliated with the Municipal Retired Employees Health Plan (MREHP), an agent multiple-employer postemployment healthcare plan administered by the Robusta Retirement System. Article 39 of the Statutes of the State of Robusta assigns the authority to establish and amend the benefit provisions of the plans that participate in MREHP to the respective employer entities; for MPHP, that authority rests with the city of Mocha. The Robusta Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for MREHP. That report may be obtained by writing to Robusta Retirement System, 399 Grocer Aisle, Caffee, RO 02000, or by calling 1-877-555-PLAN.

*Funding Policy.* The contribution requirements of plan members and the city are established and may be amended by the MREHP board of trustees. MPHP members receiving benefits contribute \$75 per month for retiree-only coverage and \$150 per month for retiree and spouse coverage to age 65, and \$40 and \$80 per month, respectively, thereafter.

The city of Mocha is required to contribute the *annual required contribution of the employer (ARC)*, an amount actuarially determined in accordance with the parameters of

GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 13.75 percent of annual covered payroll.

*Annual OPEB Cost.* For 20X2, the city’s annual OPEB cost (expense) of \$870,517 for MPHP was equal to the ARC. The city’s annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 20X2 and the two preceding years were as follows:

<b><u>Fiscal Year Ended</u></b>	<b><u>Annual OPEB Cost</u></b>	<b><u>Percentage of Annual OPEB Cost Contributed</u></b>	<b><u>Net OPEB Obligation</u></b>
6/30/X0	\$929,401	100%	\$0
6/30/X1	910,042	100	0
6/30/X2	870,517	100	0

*Funded Status and Funding Progress.* The funded status of the plan as of December 31, 20X1, was as follows:

Actuarial accrued liability (AAL)	\$19,490,482
Actuarial value of plan assets	<u>15,107,180</u>
Unfunded actuarial accrued liability (UAAL)	<u>\$ 4,383,302</u>
Funded ratio (actuarial value of plan assets/AAL)	77.5%
Covered payroll (active plan members)	\$6,331,031
UAAL as a percentage of covered payroll	69.2%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

*Actuarial Methods and Assumptions.* Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 20X1, actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 7.5 percent investment rate of return (net

of administrative expenses) and an annual healthcare cost trend rate of 12 percent initially, reduced by decrements to an ultimate rate of 5 percent after ten years. Both rates include a 4.5 percent inflation assumption. The actuarial value of MPHP assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a three-year period. MPHP's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at December 31, 20X1, was twenty-two years.

**REQUIRED SUPPLEMENTARY INFORMATION**  
**Schedule of Funding Progress for MPHP**

<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Assets (a)</b>	<b>Actuarial Accrued Liability (AAL)— Entry Age (b)</b>	<b>Unfunded AAL (UAAL) (b – a)</b>	<b>Funded Ratio (a / b)</b>	<b>Covered Payroll (c)</b>	<b>UAAL as a Percentage of Covered Payroll ((b – a) / c)</b>
12/31/W9	\$10,138,007	\$16,867,561	\$6,729,554	60.1%	\$5,984,554	112.4%
12/31/X0	12,093,839	17,572,474	5,478,635	68.8	6,182,351	88.6
12/31/X1	15,107,180	19,490,482	4,383,302	77.5	6,331,031	69.2

**Illustration 3—Notes to the Financial Statements for an Employer  
Contributing to a Cost-Sharing Multiple-Employer Defined Benefit  
Healthcare Plan**

**Brewer State University**

**Notes to the Financial Statements  
for the Year Ended June 30, 20X2**

**Note X. University Retiree Health Plan**

*Plan Description.* Brewer State University contributes to the State University Retiree Health Plan (SURHP), a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the Grande Retirement System. SURHP provides medical benefits to retired employees of participating universities. Article 38 of the Statutes of the State of Grande assigns the authority to establish and amend benefit provisions to the SURHP board of trustees. The Grande Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for SURHP. That report may be obtained by writing to

Grande Retirement System, State Government Lane, Latte, GR 01000, or by calling 1-800-555-PLAN.

*Funding Policy.* Article 38 provides that contribution requirements of the plan members and the participating employers are established and may be amended by the SURHP board of trustees. Plan members or beneficiaries receiving benefits contribute \$65 per month for retiree-only coverage and \$135 for retiree and spouse coverage to age 65, and \$35 and \$75 per month, respectively, thereafter.

Participating universities are contractually required to contribute at a rate assessed each year by SURHP, currently 8.75 percent of annual covered payroll. The SURHP board of trustees sets the employer contribution rate based on the *annual required contribution of the employers (ARC)*, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. The university's contributions to SURHP for the years ended June 30, 20X2, 20X1, and 20X0, were \$58,717, \$49,886, and \$47,375, respectively, which equaled the required contributions each year.

## Illustration 4—Defined Benefit Healthcare Plan Financial Reports

### GRANDE RETIREMENT SYSTEM

#### STATEMENTS OF PLAN NET ASSETS as of June 30, 20X2

(Dollar amounts in thousands)

	<b>State Retired Employees Healthcare Plan</b>	<b>State University Retiree Health Plan</b>	<b>20X2 Total</b>
<b>Assets</b>			
Cash and short-term investments	\$ 250	\$ 13,532	\$ 13,782
Receivables			
Employer	1,182	2,101	3,283
Employer—long-term	—	4,064	4,064
Employee	1,010	1,562	2,572
Interest and dividends	836	31,193	32,029
Total receivables	<u>3,028</u>	<u>38,920</u>	<u>41,948</u>
Investments, at fair value			
U.S. Treasuries	723,487	194,807	918,294
Federal government agencies	1,216,282	308,764	1,525,046
Corporate bonds	1,790,676	378,783	2,169,459
Corporate stocks	<u>3,271,662</u>	<u>615,773</u>	<u>3,887,435</u>
Total investments	<u>7,002,107</u>	<u>1,498,127</u>	<u>8,500,234</u>
Properties, at cost, net of accumulated depreciation of \$5,164 and \$323, respectively	<u>6,177</u>	<u>434</u>	<u>6,611</u>
Total assets	7,011,562	1,551,013	8,562,575
<b>Liabilities</b>			
Accounts payable and other	<u>7</u>	<u>51,828</u>	<u>51,835</u>
<b>Net assets held in trust for other postemployment benefits</b>	<u>\$7,011,555</u>	<u>\$1,499,185</u>	<u>\$8,510,740</u>

**GRANDE RETIREMENT SYSTEM**

**STATEMENTS OF CHANGES IN PLAN NET ASSETS  
for the Year Ended June 30, 20X2**

(Dollar amounts in thousands)

	<b>State Retired Employees <u>Healthcare Plan</u></b>	<b>State University Retiree <u>Health Plan</u></b>	<b>20X2 <u>Total</u></b>
<b>Additions</b>			
Contributions			
Employer	\$ 357,682	\$ 33,639	\$ 391,321
Plan member	<u>35,409</u>	<u>4,479</u>	<u>39,888</u>
Total contributions	<u>393,091</u>	<u>38,118</u>	<u>431,209</u>
Investment income			
Net appreciation in fair value of investments	475,914	65,845	541,759
Interest	261,540	55,939	317,479
Dividends	<u>127,853</u>	<u>22,079</u>	<u>149,932</u>
	865,307	143,863	1,009,170
Less investment expense	<u>44,996</u>	<u>9,177</u>	<u>54,173</u>
Net investment income	<u>820,311</u>	<u>134,686</u>	<u>954,997</u>
Employer interest on long-term contracts	<u>—</u>	<u>365</u>	<u>365</u>
Total additions	<u>1,213,402</u>	<u>173,169</u>	<u>1,386,571</u>
<b>Deductions</b>			
Benefits	226,108	25,568	251,676
Administrative expense	<u>2,350</u>	<u>662</u>	<u>3,012</u>
Total deductions	<u>228,458</u>	<u>26,230</u>	<u>254,688</u>
<b>Net increase</b>	984,944	146,939	1,131,883
<b>Net assets held in trust for other postemployment benefits</b>			
Beginning of year	<u>6,026,611</u>	<u>1,352,246</u>	<u>7,378,857</u>
End of year	<u>\$7,011,555</u>	<u>\$1,499,185</u>	<u>\$8,510,740</u>

## Grande Retirement System

### Notes to the Financial Statements for the Fiscal Year Ended June 30, 20X2

The Grande Retirement System (GRS) administers two defined benefit postemployment healthcare plans—State Retired Employees Healthcare Plan (SREHP) and State University Retiree Health Plan (SURHP). Although the assets of the plans are commingled for investment purposes, each plan’s assets may be used only for the payment of benefits to the members of that plan, in accordance with the terms of the plan.

#### A. Summary of Significant Accounting Policies

*Basis of Accounting.* GRS’s financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

*Method Used to Value Investments.* Investments are reported at fair value, which for SREHP and SURHP is determined by the mean of the most recent bid and asked prices as obtained from dealers that make markets in such securities. Securities for which market quotations are not readily available are valued at their fair value as determined in good faith by the custodian under the direction of the GRS board of trustees. A valuation service may be engaged to assist in the determination of fair value.

#### B. Plan Descriptions and Contribution Information

Membership of each plan consisted of the following at December 31, 20X1, the date of the latest actuarial valuation:

	<u>SREHP</u>	<u>SURHP</u>
Retirees and beneficiaries receiving benefits	31,642	4,876
Terminated plan members entitled to but not yet receiving benefits	743	2,289
Active plan members	<u>50,601</u>	<u>8,861</u>
Total	<u>82,986</u>	<u>16,026</u>
Number of participating employers	1	15



### ***State Retired Employees Healthcare Plan***

*Plan Description.* SREHP is a single-employer defined benefit postemployment healthcare plan that covers retired employees of the state including all departments and agencies. SREHP provides health and dental insurance benefits to eligible retirees and their spouses. Article 37 of the Statutes of the State of Grande assigns the authority to establish and amend the benefit provisions of the plan to the state legislature.

*Contributions.* Article 37 also assigns to the state legislature the authority to establish and amend contribution requirements of the plan members and the state. Retired plan members and beneficiaries currently receiving benefits are required to contribute specified amounts monthly toward the cost of health insurance premiums. For the year ended June 30, 20X2, plan members contributed \$35.4 million, or approximately 16 percent of total premiums, through their required contributions of \$50 per month for retiree-only coverage and \$105 per month for retiree and spouse coverage. The state is required to contribute the balance of the current premium cost (\$190.7 million, or about 84 percent of total premiums for 20X2) and may contribute an additional amount to prefund benefits as determined annually by the legislature (\$167.0 million for 20X2). Administrative costs of SREHP are financed through investment earnings.

### ***State University Retiree Health Plan***

*Plan Description.* SURHP is a cost-sharing multiple-employer defined benefit postemployment healthcare plan that covers retired employees of participating universities. SURHP provides medical benefits to plan members. Article 38 of the Statutes of the State of Grande assigns the authority to establish and amend benefit provisions to the SURHP board of trustees.

*Contributions.* Article 38 also assigns to the SURHP board of trustees the authority to establish and amend contribution requirements of the plan members and the participating employers. For the year ended June 30, 20X2, plan members or beneficiaries receiving benefits contributed \$4.5 million, or approximately 18 percent of total premiums, through their required contributions of \$65 per month for retiree-only coverage and \$135 for retiree and spouse coverage to age 65, and \$35 and \$75 per month, respectively, thereafter. Participating universities were required to contribute at a rate equivalent to the annually required contribution of the employers (ARC) (8.75 percent of covered payroll, or \$33.6 million). Administrative costs of SURHP are financed through investment earnings.

*Long-Term Receivables.* In addition to actuarially determined contributions, certain employers also make semiannual installment payments, including interest at 7.5 percent per year, for the cost of service credit granted retroactively to employees when the employers initially joined SURHP. As of June 30, 20X2, the outstanding balance was \$4.1 million. These payments are due over various time periods not exceeding five years at June 30, 20X2.

**C. Funded Status and Funding Progress—OPEB Plans**

The funded status of each plan as of the most recent actuarial valuation date is as follows (dollar amounts in thousands):

<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Assets (a)</b>	<b>Actuarial Liability (AAL)—Entry Age (b)</b>	<b>Unfunded AAL (UAAL) (b – a)</b>	<b>Funded Ratio (a / b)</b>	<b>Covered Payroll (c)</b>	<b>UAAL as a Percentage of Covered Payroll ((b – a) / c)</b>
<b>SREHP</b>						
12/31/X1	\$5,131,017	\$8,833,219	\$3,702,202	58.1%	\$2,243,759	165.0%
<b>SURHP</b>						
12/31/X1	1,301,663	1,575,136	273,473	82.6	371,168	73.7

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedules of funding progress, presented as required supplementary information following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The accompanying schedules of employer contributions present trend information about the amounts contributed to the plan by employers in comparison to the ARC, an amount that is actuarially determined in accordance with the parameters of GASB Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation follows:

	<b>SREHP</b>	<b>SURHP</b>
Valuation date	12/31/X1	12/31/X1
Actuarial cost method	Entry age	Entry age
Amortization method	Level percentage of pay, open	Level percentage of pay, open
Remaining amortization period	17 years	15 years
Asset valuation method	5-year smoothed market	5-year smoothed market
Actuarial assumptions:		
Investment rate of return*	6.7% <sup>†</sup>	7.5%
Healthcare cost trend rate*	12% initial 5% ultimate	12% initial 5% ultimate

\*Includes an inflation assumption of 4.5%.

<sup>†</sup>Determined as a blended rate of the expected long-term investment returns on plan assets and on the state's investments, based on the funded level of the plan at the valuation date.

## REQUIRED SUPPLEMENTARY INFORMATION

(Dollar amounts in thousands)

### SCHEDULES OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)— Entry Age (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
<b>SREHP</b>						
12/31/W7	\$3,696,201	\$7,189,703	\$3,493,502	51.4%	\$2,144,804	162.9%
12/31/W9	4,209,207	7,838,210	3,629,003	53.7	2,325,810	156.0
12/31/X1	5,131,017	8,833,219	3,702,202	58.1	2,243,759	165.0
<b>SURHP</b>						
12/31/W7	697,274	1,001,851	304,577	69.6	297,926	102.2
12/31/W9	935,184	1,168,147	232,963	80.1	329,473	70.7
12/31/X1	1,301,663	1,575,136	273,473	82.6	371,168	73.7

## SCHEDULES OF EMPLOYER CONTRIBUTIONS

<b>Year Ended June 30</b>	<b>Employer Contributions</b>			
	<b>SREHP</b>		<b>SURHP</b>	
	<b>Annual Required Contribution</b>	<b>Percentage Contributed</b>	<b>Annual Required Contribution</b>	<b>Percentage Contributed</b>
19W9	\$535,307	54.3%	\$29,047	100%
20X0	501,102	66.9	31,056	100
20X1	542,812	64.3	32,123	100
20X2	577,180	62.0	33,639	100